

GUIDING PRINCIPLES FOR EFFECTIVE  
FINANCIAL MANAGEMENT OF  
DEPARTMENT OF ENERGY'S CONTRACTORS

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# **GUIDING PRINCIPLES FOR EFFECTIVE FINANCIAL MANAGEMENT OF DOE's CONTRACTORS**

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# INTRODUCTION

The Department of Energy has entered a new era in how it manages its contracts. Contract reform, new legislation, and performance-based contracts have thrust the Department into new paradigms of contract administration and contractor oversight.

For the Department's Chief Financial Officer (CFO) community, these changes have created a need to re-think traditional paradigms of financial management and contract administration. Historical oversight processes--including compliance reviews and on-site financial inspections by field office personnel--have been reduced in favor of performance-based contract reforms and initiatives.

In addition, Field Managers and the CFO community have been impacted by recently enacted laws that have placed more responsibilities on Field Managers and their Field CFOs. For example, the Government Performance and Results Act (GPRA) of 1993, and the Government Management Reform Act (GMRA) of 1994 seek to make government more effective and responsive through improved financial planning and more meaningful customer oriented financial information.

Perhaps most importantly, the CFO community recognizes its critical responsibility to provide management at all levels with the financial information necessary to make sound decisions in a time of scarce resources and rapidly shifting mission priorities. Field Managers and other partners must have assurance that the Department's contractors' financial management practices, systems and results possess integrity, provide timely and relevant information, and can be relied upon.

All of these forces have produced the need for a comprehensive approach for effective financial management of the Department's contractors. To address these issues and opportunities, the Acting Chief Financial Officer, Don Pearman chartered the DOE Financial Management Guiding Principles Task Team, with representatives from DOE Headquarters (HQ) CFO, Office of Field Management (FM), Office of the Inspector General (OIG) and field offices, charged with **developing guiding principles for effective financial management of the Department's contractors**. Two primary objectives of the team in crafting the guiding principles were:

- Developing processes and methods of evaluating contractor financial management performance which satisfy the spirit and intent of the Department's Contractor Performance-based Business Management Process, and
- Ensuring that the guiding principles satisfy the Department's legally mandated responsibilities related to responsive, economical, efficient, and effective financial administration

The following pages provide guiding principles for effective financial management of DOE's contractors that achieve the two primary objectives and facilitate the new paradigm. It describes a comprehensive model of effective financial management that, when implemented, will give the Department, its Field Managers and their Field Chief Financial Officers assurance that the DOE's contractors have sound, responsive and economical financial management programs. It will achieve the critical goal of providing timely and meaningful financial information for effective

decision-making purposes. Finally, we have set forth a flexible approach that each field office may use to design its own financial management program consistent with these guiding principles.

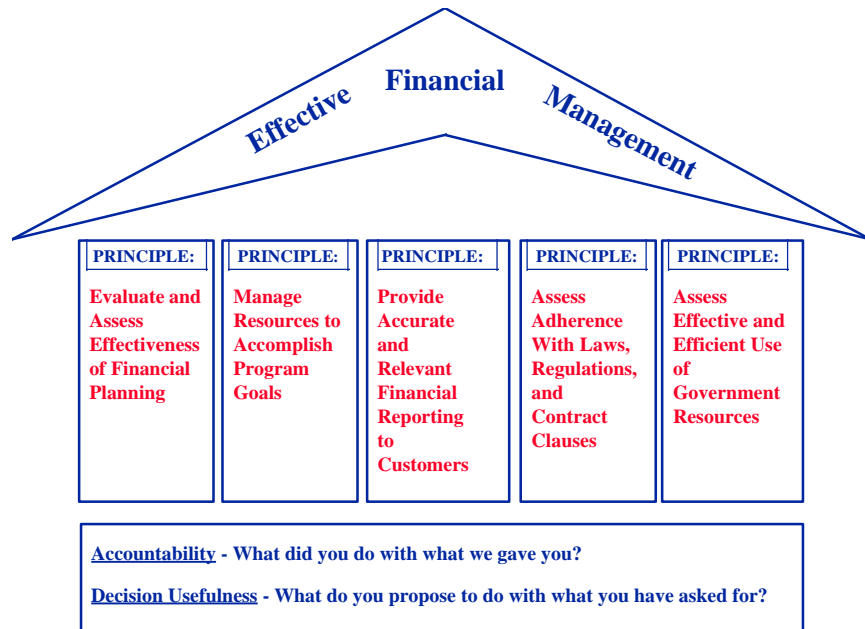
This report lays the legal and conceptual framework of the Guiding Principles for Effective Financial Management. Appendix D outlines practical approaches to implementing the Guiding Principles, using processes and methods in place at two DOE Operations Offices.

## I. GUIDING PRINCIPLES FOR EFFECTIVE FINANCIAL MANAGEMENT

### OVERVIEW

Figure 1 portrays a comprehensive model of effective financial management of DOE's contractors. The picture of a house is used, depicting a foundational philosophy (primary drivers) upon which the key pillars (guiding principles) support the roof (effective financial management).

Figure 1



Regardless of the type of contract negotiated with the contractor, the DOE Field Office and the contractor share financial stewardship and fiduciary responsibilities. Contractors are required to use the taxpayers money responsibly, to conduct operations in an efficient and effective manner, to ensure that funds are expended in accordance with provisions of the contract and applicable appropriations laws respectively, and to adequately account for costs charged to the Government under their contract. The Field Office must provide Headquarters, OMB and the Congress reasonable assurance that these requirements are being met and that adequate systems and

controls are in place for preventing fraud, waste, abuse and mismanagement of Government assets.

Performance-based management and performance measures are tools that can help provide reasonable assurance. However, continuous operational awareness is needed to supplement performance-based management. Simply stated, operational awareness is knowing what the contractor is doing, having a good understanding of how their systems and processes work, and knowing the degree of reliance that can be placed on the contractor's systems, processes, and performance measures. It requires partnering with contractor personnel including their CFO, other administrative personnel, and program or project personnel to the extent necessary to understand how goals are being established, budgeted for, and tracked so that programs and projects are accomplished within budget and targets to the maximum possible extent

Performance measures and operational awareness are also supplemented as necessary with oversight and reviews. Contractors perform self-assessments based upon agreed to performance measures and targets. Annual reviews of business activities are scheduled under the Department's Business Management Process and these reviews can be used to evaluate systems, processes, and internal controls as well as to validate reported performance. In addition, "for cause" reviews can be conducted when there is a known or suspected problem or other demonstrated reason for conducting such a review. One way of maximizing the use of our scarce resources for analysis and review activities is to use a risk-based approach which focuses on the highest risk areas for review and analysis. Such an approach should include partnering with the Inspector General and contractor internal audit staffs to avoid duplicate coverage and to reach consensus on high risk areas that need analysis and review.

### **A. Primary Drivers of Effective Financial Management**

As shown in Figure 1, the two primary drivers that form the foundation for effective financial management are **accountability** and **decision usefulness**. Ensuring accountability for Government resources and assets is one of the most dynamic and difficult responsibilities of management throughout the Government and its private sector contractors. In order to meet this responsibility, managers need an oversight process that will ensure a positive answer to the question "Did we use our resources effectively, in accordance with program priorities, and in compliance with laws and regulations?"

The second primary driver, decision usefulness, mandates that the structure and integrity of financial accounting systems are proficient in providing current, accurate, and relevant information. This is necessary to enable managers to make prudent, informed decisions affecting their operations. Thus, managers need a financial management system that positively answers the question "Is reliable, timely, and useful financial information available to assist us in making effective management decisions?"

## **B. Guiding Principles**

The model shown in Figure 1 describes five guiding principles that constitute effective financial management. Successful accomplishment of each of these principles should provide management assurance that the contractor has a sound financial management program that provides for accountability and informed management decision making. The five guiding principles are described below. It is important to keep in mind that all of the elements of this concept are necessary to assure effective financial management. Eliminating any of the elements, or insufficient performance of any element, will result in less than effective financial management.

### **Principle 1. Evaluate and Assess Effectiveness of Financial Planning**

Field Managers rely upon their Field CFOs for assuring that resources are available to meet DOE mission requirements. Therefore, budgets must be formulated with programmatic insight, resulting in justifiable requests for resources to satisfy mission needs. The financial community must partner with functional and program managers to ensure that limited financial resources are allocated in order of priority and that these resource allocations are used for their intended purposes.

### **Principle 2. Manage Resources to Accomplish Program Goals**

To assure that program priorities are achieved within provided funding levels, systems must be in place that provide management with timely insight into trends and financial results. Therefore, the CFO monitors budget execution, including monitoring projects, tasks, program accomplishments, and the overall financial health of its operations to ensure that plans and priorities are achieved.

### **Principle 3. Provide Accurate and Relevant Financial Reporting to Customers**

It is paramount that all levels of DOE management have current, accurate and relevant financial data for sound decision making. In addition, this information must be presented in a useful format that addresses the needs of individual managers. Financial information is essential to planning, real-time decision making, and assessing program performance.

### **Principle 4. Assess Adherence to Laws, Regulations, and Financial Contract Clauses**

Over the years, Congress has enacted several laws making Departmental officials accountable for financial integrity, performance and stewardship. Therefore, the Department has the responsibility to ensure that all applicable laws and regulations are carried out to ensure responsible use of taxpayer dollars and protection of the Department's assets against fraud, waste, abuse, and mismanagement. A summary of laws and regulations currently applicable to the financial community is provided as Appendix B to this document.

### **Principle 5. Assess Effective and Efficient Use of Government Resources**

A main CFO responsibility is to ensure that scarce resources are being utilized economically and efficiently. Oversight efforts and analyses should focus on high impact areas. These high impact

areas should be determined through the use of risk assessments that identify the degree of probability of loss, exposure, or detriment to the Department as a result of ineffective, inefficient, or noncompliant processes. Emphasis should be placed on identifying deficiencies during infancy stages of projects and processes in order to take timely corrective actions. There should also be emphasis on identifying and implementing commercial best business practices that includes modernization of systems, reengineering, decentralized control, application of modern quality principles, and implementation of electronic commerce. Consistent with these concepts should be the design and management of business processes which balance the risk of loss or exposure with the cost of control and compliance activities.

## **II. METHODS AVAILABLE TO ACCOMPLISH GUIDING PRINCIPLES**

The Contractor Performance-based Business Management Process (BMP) is the Department's mechanism for assessing financial management. The BMP is a performance based management concept consisting of (1) operational awareness, (2) partnerships between the contractor and field office, (3) financial management risk assessment, (4) performance objectives/measures, (5) contractor self-assessments, (6) an annual review, and (7) "for cause" reviews.

### Operational Awareness

Operational awareness is the day-to-day management of those activities which enable the Department to determine how well the contractor is performing to meet the requirements of the contract. Factors influencing the degree of operational awareness include the nature of the work, the type of contract, and past performance of the contractor. Specific activities constituting an ongoing operational awareness process should be defined and understood by Field Element Management and its contractors.

Operational awareness analyses and activities are the most effective means which financial managers can use to obtain assurances that the five guiding principles of effective financial management are being met. These day-to-day activities are critical to identify problem areas in their earliest stages to provide the opportunity for development of corrective action plans. An illustrative summary of many available operational awareness activities that can be used to achieve effective financial management are provided in Appendix C of this document. Appendix D of this report also outlines several working operational awareness practices now being used within the Department.

### Partnership Between the Contractor and Field Office

An effective system is built upon open communication, partnership and trust at all levels - Headquarters CFO and program offices, field CFO offices and contractors. This coordination and cooperation is necessary to ensure mutual understanding of required performance.

## Financial Management Risk Assessment

Due to the Department's scarce resources, attention should be focused on the vital few internal control systems needed for effective financial management. The risk assessment process provides a listing of financial management activities ranked by relative priority and risk posed to the entire financial organization. The results of the risk assessment provide a corporate statement on responsibility and risk, drives the measurement process, and establishes priority for evaluation of financial management control systems.

## Performance Objectives/Measures

The use of performance-based management is the cornerstone of the BMP. This concept is results-oriented, focusing on agreed-to, predetermined performance objectives, measures, and expectations. Contractor performance is evaluated based upon the level of performance demonstrated against the performance expectations.

## Contractor Self-Assessment and other Authoritative Reviews

The contractor annual self-assessment is the primary mechanism for evaluating contractor performance measures against the predetermined performance objectives, measures, and expectations. The self-assessment should as a minimum include (a) an assessment against performance objectives, measures and expectations, (b) a description of how in process measures are being met; including internal controls and compliance, and (c) identification of improvement opportunities. In conjunction with the contractor self-assessment, OIG, General Accounting Office and contractor internal audit reports are also utilized in evaluating contractor financial management performance.

## Annual BMP Review

Once a year, DOE performs a review of the contractor. This review is scheduled to occur after the contractor's submission of their self-assessment. At a minimum, DOE should validate the contractor self-assessment by analyzing supporting documentation that provides reasonable assurance that the self-assessment was based on current and accurate data.

## For Cause Reviews

For cause reviews are performed as a result of the identification of significant problems or trends through day-to-day operational awareness and ongoing analysis of contractor self-assessments. These reviews will vary in scope from brief fact-finding assessments to extensive, detailed reviews, depending upon the circumstances. These reviews may be performed on a priority basis at any time throughout the year.

The guiding principles outlined in this document apply to all DOE Operations and Field Offices. However, specific analytical activities should be tailored to fit each location. Various activities available to perform financial management oversight are provided for your information in Appendix C.



## **Appendix A**

## **GLOSSARY OF TERMS**

Operational Awareness - Operational awareness is the day-to-day management of those activities which enable the Department to determine how well the contractor is performing to meet the requirements of the contract. Factors influencing the degree of operational awareness include the nature of the work, the type of contract, and past performance of the contractor. Specific activities constituting an ongoing operational awareness process should be defined and understood by Field Element Management and its contractors.

For Cause Review - Review of contractor operations or performance which is required as a result of poor performance or trends indicating the potential for improvement requiring the Department of Energy follow up to protect the Government's interest. They may also arise from implementation of new requirements on the contractor, or new contractor systems, requiring validations.

Risk Assessment - An evaluation of relative priority of risks in relationship to other risks to achieve management objectives.

Performance Measures - A quantitative or qualitative method for characterizing performance.

Internal Controls - The process in place to ensure that management's objectives are accomplished while preventing, detecting, or correcting fraud, waste, abuse, or mismanagement.

Risk - The degree of probability of loss, exposure, or detriment to the Department as a result of ineffective, inefficient, or non-compliant processes.

Validation - A verification of the adequacy of internal controls or of the information provided.

Self-Assessment - An annual report prepared by the contractor which reports in greater detail the accomplishments, effectiveness, and efficiency of financial management systems.

Financial Stewardship - The ultimate product is the achievement of the goal of financial stewardship to provide for the effective and efficient execution of financial responsibilities to help ensure optimum use of taxpayers' dollars and protection of the Department's assets against fraud, waste, abuse, and mismanagement.

Annual Review - A multi-disciplined on-site business review of a contractor. The on-site portion of such reviews shall last no longer than two weeks.

## **Appendix B**

## **APPLICABLE LAWS AND REGULATIONS**

### **Federal Acts**

#### Federal Managers' Financial Integrity Act of 1982

This act requires that the head of each agency conduct an evaluation in accordance with guidelines, prepare a statement concerning the agency's system of internal accounting and administrative controls of each executive agency. The requirements of this act include providing reasonable assurance that:

- obligations and costs are in compliance with applicable law,
- funds, property, and other assets are adequately safeguarded against waste, loss, unauthorized use or misappropriation,
- revenues and expenditures are properly recorded to provide for reliable financial reporting and maintenance of accountability over assets,
- prompt resolution of audit findings, and
- an annual evaluation of the agency's systems of internal accounting and administrative controls including any identified material weaknesses with commensurate corrective action plans.

#### OMB Circular A-127 "Financial Management Systems"

This circular states that financial and program managers are accountable for financial results of actions taken, control over the Federal Government's financial resources and protection of Federal assets. Specific requirements of this circular include:

- Each agency shall maintain a single, integrated financial system,
- Financial systems must be designed in a manner consistent with the US Government Standard General Ledger, and is capable of tracking specific program expenditures.
- Integrated financial management systems must possess (1) common data elements, (2) common transaction processing, (3) consistent internal controls and (4) efficient transaction entry.
- Agency financial management systems shall be able to produce financial information required to measure program performance, and support budgeting, program management and financial statement presentation.

#### OMB Circular A-123 "Management Accountability and Control"

This circular states that managers are responsible for the quality and timeliness of program performance, increasing productivity, controlling costs, and comply with applicable laws. The circular requires Agencies and individual Federal managers to take systematic and proactive measures to:

- Develop and implement cost-effective management controls for results-oriented management,

- Assess the adequacy of management controls in Federal programs and operations,
- Identify needed improvements,
- Take corresponding corrective action, and
- Report annually on management controls

### Chief Financial Officers Act of 1990

This Act requires Agency CFOs to:

- Provide for improvement of systems of accounting, financial management and internal controls to assure the issuance of reliable financial information and to deter fraud, waste and abuse of Government resources,
- Report directly to the head of the Agency regarding financial management matters,
- Oversee all financial management activities relating to the programs and operations of the Agency,
- Develop and maintain an integrated agency accounting and financial management system including financial reporting and internal controls which provides for (1) complete, reliable, consistent and timely information (2) the development and reporting of cost information (3) the integration of accounting and budgeting information and (4) the systematic measurement of performance,
- Implement agency asset management systems, including systems for cash management, credit management, debt collection, and property and inventory management and control,
- Monitor the financial execution of the budget of the agency in relation to actual expenditures, and prepare and submit to the head of the agency timely performance reports,
- Perform biennial pricing reviews for fees, royalties, rents, and other charges imposed by the agency for services and things of value it provides, and
- Prepare and submit to the Director, OMB, a financial statement for the preceding fiscal year.

### Government Performance and Results Act of 1993 (GPRA)

This act provides for the establishment of strategic planning and performance measurement. The act requires agencies to submit five-year strategic plans to OMB and Congress by September 30, 1997, concurrent with transmittal of FY 1999 budget requests. The five-year strategic plans are to be updated at least every three years. The strategic plans shall include:

- A comprehensive mission statement covering the major functions and operations of the agency.
- General and outcome related goals and objectives for the major functions and operations of the agency.
- A plan for achieving the goals and objectives that includes a description of the operating processes, skills and technology, and resources required to meet the goals and objectives.
- A basis for comparing actual program results with the established program goals.
- A description of the process to verify and validate measured values.
- Identification of barriers to achievement of the goals and objectives.

- A description of the program evaluations used in establishing or revising general goals and objectives, with a schedule for future program evaluations.

#### Government Management Reform Act of 1994 (GMRA)

This act requires:

- that the head of each executive agency shall prepare and submit to the Director, OMB, an audited financial statement for the preceding fiscal year, reflecting (1) the overall financial position and (2) results of operations.

#### Anti-Deficiency Act

This act states that:

- It is permissible to establish reserves for contingencies or to effect savings, whenever savings are made possible by or through changes in requirements or greater efficiency of operations.
- An officer or employee of the US Government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation.
- An officer or employee of the US Government may not involve the Government in a contract or obligation for the payment of money before an appropriation is made, unless authorized by law.
- An officer or employee of the US Government may not accept voluntary services for the government or employ personal services exceeding that authorized by law, except for emergencies involving the safety of human life or the protection of property.
- Violations of this act will be reported immediately to the President and Congress with relevant facts and a statement of action taken.

#### Debt Collection Improvement Act of 1966

This act requires all federal payments under the Internal Revenue Code of 1986 to be made by electronic funds transfer, and by January, 1999, all vendor payments will be made electronically.

## Federal Financial Improvement Act of 1996

The purposes of this act are to:

- Provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government,
- Require Federal financial management systems to support full disclosure of Federal financial data, including the full cost of Federal programs and activities, to the citizens, the Congress, the President, and agency management, so that programs and activities can be considered based on their full costs and merits,
- Increase the accountability and credibility of Federal financial management,
- Improve performance, productivity, and efficiency of Federal Government financial management,
- Establish financial management systems to support controlling the cost of Federal Government and
- Increase the capability of agencies to monitor execution of the budget by more readily permitting reports that compare spending of resources to results of activities.

## **Appendix C**

### **FINANCIAL MANAGEMENT ACTIVITIES THAT SUPPORT THE GUIDING PRINCIPLES**

The following table provides a cross-reference showing the guiding principles of effective financial management, and corresponding activities that can be used to assure management that each guiding principle is satisfactorily performed by its contractor(s). The guiding principles are as follows:

- Principle 1. Evaluate and Assess Effectiveness of Financial Planning
- Principle 2. Manage Resources to Accomplish Program Goals
- Principle 3. Provide Accurate and Relevant Financial Reporting to Customers
- Principle 4. Assess Adherence to Laws, Regulations, and Financial Contract Clauses
- Principle 5. Assess Effective and Efficient Use of Government Resources

Activities	Principle 1	Principle 2	Principle 3	Principle 4	Principle 5
Maintain awareness of contractor financial system management controls			◆	◆	
Perform periodic reviews of related party transactions				◆	◆
Administer Federal Manager's Financial Integrity Act (FMFIA)				◆	
Perform biennial pricing review			◆	◆	
Analyze financial statements and other accounting reports	◆	◆	◆	◆	◆
Conduct award fee administration duties				◆	◆
Respond to urgent ad hoc HQ directed requests for information				◆	
Determine contractor conformance with financial laws and regulations			◆	◆	
Analyze and validate expense funded projects	◆	◆	◆	◆	
Certify funding availability	◆			◆	
Validate/certify annual cost incurred and claimed			◆	◆	◆
Analyze/review/approve overhead rates and allocations	◆		◆		
Partner with contractor and HQ to monitor financial status and timely close-out of completed projects/activities/contracts	◆	◆	◆		◆
Analyze and validate pension, environmental, contingent liabilities	◆	◆	◆		◆
Analyze significant budget variances		◆	◆		◆
Analyze results of financial audits/reviews conducted		◆	◆		◆
Partner with technical organizations in work authorization and change control systems		◆	◆		◆
Conduct management directed special cost studies/analyses	◆	◆	◆		◆
Review final indirect cost rate submissions	◆	◆	◆		
Validate selected contractor make vs buy decisions	◆	◆			◆
Trend and analyze costs	◆	◆			◆
Periodic liaison meetings with contractors.	◆	◆			◆
Conduct risk assessments	◆	◆			◆
Analyze contractor budget submissions	◆	◆			
Perform fee base analysis	◆				
Assess internal audit function		◆			◆
Partner with internal auditors and external audit agencies		◆			◆
Provide meaningful financial information and analysis to program people and others		◆			◆
Partner with technical organizations to achieve effective contractor resource utilization		◆			◆
Partner with counterparts to validate selected cost reduction efforts and other incentives					◆

Because the guiding principles are interrelated, some financial management activities apply to two or more principles. This exemplifies the need to integrate all of these activities into a comprehensive oversight program. Utilization of the financial management activities presented above, in conjunction with the performance-based management approach specified by the BMP, provides the framework for a comprehensive, focused and effective oversight program of DOE's contractors.

Presented below are brief narrative descriptions of the financial management activities that support the guiding principles.

Maintain awareness of contractor financial system management controls, particularly changes to operations.

The CFO should possess a detailed understanding of the contractor's automated financial systems and its integration with management controls such as its approved policies and procedures. This understanding and awareness can be accomplished through routine meetings, briefings, and reviews of financial reports. This routine interaction is necessary to assure that any changes to operations have not adversely impacted the integrity of financial data. The CFO Act requires federal review and acceptance of contractor accounting systems for assurance that they comply with federal and commercial standards and include adequate controls over financial processes and record-keeping. As part of this approval process, DOE must ensure that the contractor provides a Disclosure Statement detailing cost accounting practices that are in conformance with CAS and GAAP requirements

Perform periodic reviews of related party transactions.

Related party transactions include transactions between a contractor and an affiliated party. These reviews are performed to provide reasonable assurance that contractor related party transactions have been identified, are in conformance with DOE requirements, and qualify as an arm's length transaction. The review of contractor's related party transactions is an annual requirement.

Partner with counterparts to validate selected cost reduction efforts and other incentives.

Many DOE Operations and Field Offices have established Cost Reduction Incentive Programs where the contractor is compensated for innovative accomplishments that exceed expectations of normal business operations. The CFO is responsible for ensuring that the accomplishments are genuine and that computations of claimed benefits and cost savings are accurate. Performance may be tracked through a performance measure.

Assess Internal Audit Function.

The tri-party Cooperative Audit Strategy, comprised of Field Office, OIG, and DOE contractor internal audit representatives, aimed to improve overall audit coverage by utilizing all available resources. This increased reliance on contractor internal audit groups by the Department makes it imperative that the CFO assess the audit work they perform. The CFO should, at a minimum, ensure that audits focus on areas of greatest risk and that internal audit workpapers are conducted in conformance with Generally Accepted Government Auditing Standards (GAGAS or Yellow Book) and to verify achievement of independent, supportable conclusions.

Administer Federal Managers Financial Integrity Act (FMFIA).



Heads of Departmental Elements are required to report annually on the management controls and financial management system(s) in their respective programs and administrative functions. This information is reported through issuance of an annual assurance memorandum and typically includes current reportable problems and status updates of previously reported problems.

Partner with Internal Auditors and external audit agencies (OIG, GAO, DCAA, etc.)

The CFO coordinates with the OIG and internal auditors to design comprehensive audit strategies and schedules. This is necessary to avoid duplication of efforts and to ensure adequate coverage of high risk areas as well as regulatory mandated requirements. This joint effort should occur periodically throughout the year to incorporate any changes in subject priority and to recognize tasks accomplished. The CFO also performs liaison duties which include coordinating meetings, facilitating management responses to audit reports, assisting in audit resolution, responding to OIG “hotline” calls referred to DOE Operations and Field Offices, etc.

Validate selected contractor make vs. buy decisions.

It is often necessary for the CFO to verify data and computations regarding high visibility/high impact make vs. buy decisions. As necessary, the CFO will analyze all cost elements of the related estimates to determine accuracy, allocability, reasonableness, and completeness. In addition, the CFO will often provide an independent opinion on potential unidentified contingencies.

Review final indirect cost rate submissions.

Final indirect rate audits are necessary to identify under/overpayments and close out subcontracts. These reviews analyze all indirect cost (frequently using statistical sampling) for allowability, accuracy, allocability, and reasonableness. The acceptable costs are translated into indirect rates used to distribute costs to the various contracts comprising the allocation base.

Perform Biennial Pricing Review

This is a requirement of the Chief Financial Officers Act. DOE's contractors provide goods and services to non-DOE entities and must develop prices for such goods and services. CFO employees must review and validate these prices to assure that they are consistent with public policy and do not over- or under-charge the recipients of goods and services.

Trend and Analyze Costs

This activity involves gathering information on selected costs (such as inventory growth, travel costs, training costs, equipment costs, overtime, etc.), and performing analysis and trending to determine whether costs are prudent, consistent with predetermined plans or agreements, or whether there are any anomalies requiring attention. Some operations offices perform this activity through receipt of existing recurring reports, others have on-line access to contractor financial

systems. Occasional checks of contractor's ledgers may be appropriate when on-line access is not available.

#### Analyze/Review/Approve Overhead Rates and Allocations

At each major DOE contracted operation, hundreds of millions in indirect and direct costs are allocated to end cost objectives via overhead pools. In addition, DOE contractors develop and utilize standard rates for allocation of such items of indirect cost as labor, G&A expenses, and information resource expenses. In order to assure that such costs are properly allocated, laws governing augmentation of appropriations are complied with, and that direct/indirect costs are being accounted for appropriately, operations office personnel analyze the components and allocation methodology employed in overhead cost formulation and distribution.

#### Analyze Financial Statements and Other Accounting Reports

The primary purpose of analyzing financial statements is to disclose any unusual trends or unacceptable conditions, such as unusual growth in construction work in process or extraordinary increases in liability accounts. In addition, an annual OIG audit of financial statements is required by the CFO Act. Where contractor's financial data is integrated with DOE accounts, field CFO's are responsible for the integrity, accuracy and proper classification of all financial statement data. In order to assure themselves that financial results and statements are consistent with GAAP, CAS and federal laws and regulations, field CFOs must conduct on-going analyses of the integrity of those statements and results.

#### Conduct Award Fee Administration Activities

DOE contracts with award fee provisions require assessment and analysis of contractor performance. Many operations offices have award fee administration as a component of the field CFO. In any event, field CFO personnel must evaluate and assess contractor financial performance as part of the award fee process.

#### Provide Meaningful Financial Information and Analysis to Program People and Others (i.e., Upper Management)

Program staff and senior management at DOE operations offices require insightful, objective financial information in order to effectively status and carry-out their program responsibilities. This need is accomplished through periodic briefings, executive-level financial reporting, providing graphical analyses and through other tools. In order to provide DOE management with meaningful financial information, field CFO personnel must be conducting on-going analyses of contractor financial results.

#### Partner with Contractor and HQ to Monitor Financial Status and Timely Close-out of Completed Projects/Activities/Contracts

Processing financial closure activities related to completed projects, contracts and other work taskings is critical to providing accurate, up-to-date financial results. These activities include

performance of final indirect rate audits necessary to accurately allocate reasonable and allowable costs to the appropriate allocation bases. These activities are also critical to releasing unexpended funds, or identifying previously unknown funding liabilities. Operations office personnel need to know the status of close-out activities for the reasons stated above, and also to assure accurate, clean, audited financial statements.

#### Respond to Urgent Ad Hoc HQ Directed Requests for Information (Review/Analyze/Validate Contractor Adherence to Policy and Direction)

Field CFO's frequently receive urgent HQ direction to verify or assure adherence to Congressional or Departmental policy is adhered to by DOE contractors. These requests may involve validating uncosted balances in B&R accounts, working with contractors to expedite line item construction project close-outs, verifying that contractor depreciation methodology is consistent with DOE requirements, etc. These requests come to the field continuously throughout the year and may involve extensive contact with contractor personnel and review of contractor documentation and processes or information.

#### Determine Contractor Conformance with Financial Laws and Regulations

A prime element of contract administration involves assurance that relevant laws and regulations are being followed. This fiduciary responsibility is necessary to protect the taxpayer's interests and to mitigate the probability of fraud, waste and abuse. This activity is also necessary to fully carry out responsibilities under the Federal Managers Financial Integrity Act.

#### Analyze and Validate Pension/Environmental/Contingent Liabilities

Field CFOs must certify the accuracy and completeness of disclosed financial liabilities of contractors. In addition, such liabilities must be fully disclosed in departmental financial statements and related footnotes and management representation letters.

#### Analyze and Validate Expense Funded Projects

Federal law prohibits the use of operating (expense) funds for many capital activities, and vice-versa. When contractors propose expense-funded capital projects, it is incumbent upon field CFO personnel to review and validate that such projects meet the demanding criteria for expense funding. This has historically been an area of frequent congressional interest and repeated problems for the Department.

#### Certify Funding Availability

Federal law prohibits performing work for private parties and certain governmental entities in the absence of advance funding. This is an inherently governmental responsibility under the Anti-Deficiency Act and other related statutes.

### Validate/Certify Annual Cost Incurred and Claimed

Contractors who operate under Treasury Letter of Credit financing (most contractors) are required to submit an annual statement of cost incurred and claimed. Field CFO personnel are required to perform whatever analysis and validation is needed of contractor costs and related controls to assure that all costs claimed and paid to contractors are allowable under federal law and contract terms.

Analyze Significant Budget Variances - To determine the effective utilization of budget resources by evaluating budget variances related to budgeted vs. actual costs, including indirect costs. Additional examples include analyses of uncosted balances, allocable costs, functional costs, and manpower reports.

Periodic Liaison Meetings With Contractors - To gain the integrated operational understanding of the effectiveness of the contractor's financial management processes and results of operations. These interactions provide the basis for a comprehensive and complete evaluation of contractor financial management performance. The frequency of visits will be determined by the proximity of each contractor to the Operations Office. The visits can be effectively performed through face-to-face interactions, televideo meetings, or teleconferences, depending upon the urgency of issues needing resolution.

Conduct Risk Assessment - To focus effort on the vital few control systems needed for effective financial management. The risk assessment provides a listing of financial management activities ranked in relative priority, relating to the risk posed to the entire financial management organization. The listing provides a corporate statement of responsibility and risks, drives the performance measurement process and establishing priority for the evaluation of management control systems.

Analyze Results of Financial Audits/Reviews Conducted (Evaluate Deficiencies) - To provide an understanding of the overall health of financial processes at the contractor, utilizing a tracking system to analyze and trend results of corrective action plans. The relevant findings should be communicated to the appropriate senior and program managers. Also, includes review of audit plans and tracking of audit plan progress to aid in evaluating performance of internal audit functions at the contractor.

Analyze Contractor Budget Submissions - To assure that the contractor budget submissions are formulated according to DOE guidance, and that the estimates provide a reasonable, justifiable, budget request. This review includes determining the appropriate funding sources (capital Vs operating) for the requested expenditure. This review is conducted in conjunction with cognizant program managers so that reasonable resource requirements can be determined.

Partner With Technical Organizations in Work Authorization and Change Control Systems - To ensure appropriately categorized, authorized work is accomplished within funding limits. For change control systems, justify and validate changes in scope and evaluate changes in funding needs. Both analyses are done in conjunction with the appropriate program manager.

Partner with Technical Organizations to Achieve Effective Contractor Resource (Material and Human) Utilization - To determine the effectiveness of the budget formulation and execution activities at the contractor. This evaluation is done in conjunction with the appropriate program manager to determine the effectiveness of resource utilization.

Perform Fee Base Analysis - To ensure that the fee paid to the contractor is based on an authorized, agreed upon scope and volume of work. The current year available fee is based on anticipated scope of work, and can reflect adjustments to the prior year fee, if actual scope of work is different than anticipated.

Conduct Management Directed Special Cost Studies/Analyses - To evaluate requirements, related costs and make appropriate recommendations to management regarding the results of the study or analysis. Examples include, product-related studies, resource studies, and cost-benefit analyses.

**WORKING MODELS DEMONSTRATING THE  
GUIDING PRINCIPLES IN PRACTICE****I. INTRODUCTION**

The preceding report explains the theoretical and legal framework for developing Guiding Principles for Effective Financial Stewardship of DOE's contracted operations. This appendix provides two existing models for financial stewardship that are currently operational within DOE, appendix showing how the Guiding Principles can work practically, using the processes in place and operating at the Savannah River and Albuquerque Operations Offices.

The value in describing the SR and AL models includes the following features:

- SR is co-located with its prime Management and Integrating contractor facilities, while the other office (AL) oversees several geographically dispersed contractors
- AL includes National Laboratories which present unique stewardship relationships due to their multi-program responsibilities
- The two models demonstrate that effective financial stewardship practices can be flexibly tailored to each site (i.e., "one size does not fit all")
- These two models are in operation, thus other DOE sites can evaluate applicability of specific practices to their operations and adopt those practices which make sense (avoids re-inventing the wheel)

Keep in mind that these models are not intended to be prescriptive, rather they are intended to be illustrative of how the Guiding Principles can be turned into practical processes for assuring effective financial stewardship of DOE's contracted operations.

**II. SAVANNAH RIVER FINANCIAL STEWARDSHIP PROCESS**

SR began developing its current process in 1992, partly in response to a recognized need for more effective financial contract administration. The following processes have evolved since 1992, and keep changing in response to changing mission and funding needs, and as "continuous improvement" identifies more effective means of financial stewardship.

SR is co-located with its primary Management and Integrating contractor. Therefore, some measures of effective stewardship (such as weekly financial strategy meetings between the SR CFO and its M&I CFO) would be impractical at geographically dispersed operations.

The Savannah River approach to financial stewardship resulted from working with contractor personnel including the appropriate program managers for many long hours. The process has been developed during the past several years and many improvements have been made along the

way. This partnering has led to better performance measures and a better understanding on both sides as to overall expectations. It has also led to DOE personnel having a better awareness of what the contractor is doing and how the contractor's systems and processes work. The end result is that managers on both sides have better management data and a greater comprehension as to the end goals, how they are to be achieved, and how progress will be monitored and measured. In summary, it takes hard work and time to fine tune a system that works in a given environment. However, many of the lessons already learned at Savannah River should prove useful to others who want to use a similar approach to financial stewardship.

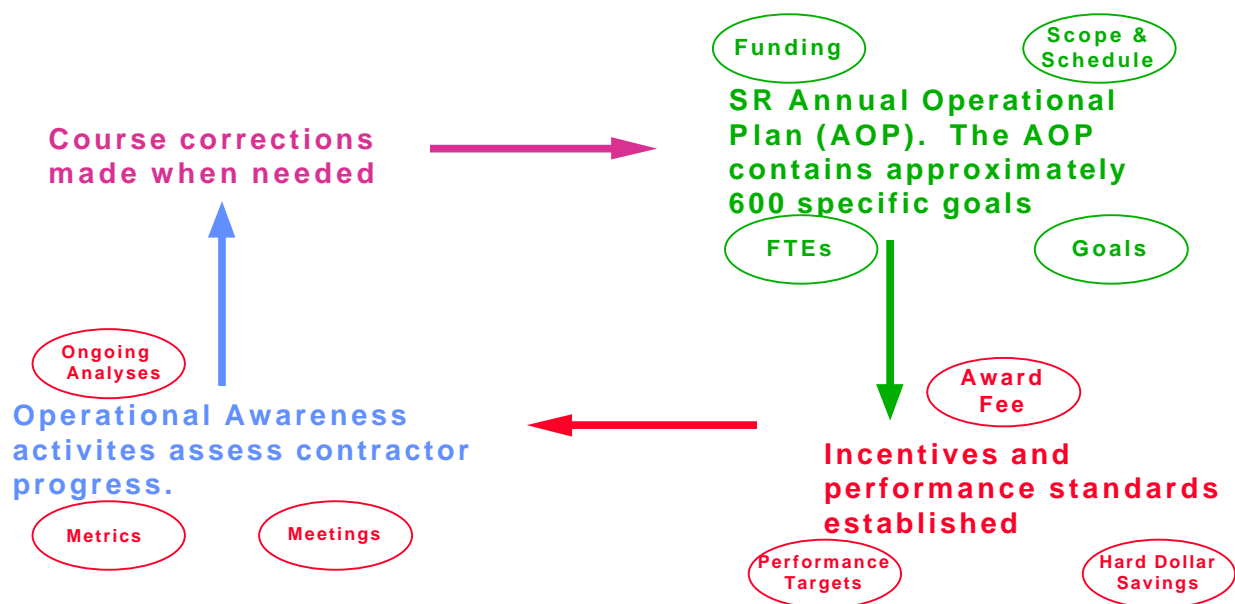
SR developed the following processes in full partnership with its M&I contractor, Westinghouse Savannah River Company. Without this partnership, it is certain that the processes developed would have been far less effective and comprehensive.

### **A. SR'S CENTRAL FEATURE**

Critical to SR's financial stewardship process, is the development of detailed, annual program and financial goals. These goals, embodied in SR's **Annual Operating Plan (AOP)**, form the foundation for assessing and measuring effective financial stewardship as the year of execution unfolds. Included in the AOP are Program Performance Plans, with resource targets, Contractor Incentive Goals, and Business Management Process targets.

In the year of AOP execution, SR utilizes a plethora of Operational Awareness Activities and Analyses (described below) to measure how well its M&I contractor is achieving the comprehensive goals agreed to in the AOP. This process is illustrated below:

## **SR's Annual Business Cycle**



SR's AOP contains approximately 600 individually tracked goals and measures, and covers all programmatic and administrative functions included in the contract. Some illustrative examples of these 600 goals are shown below:

- Achieve a \$750,000 net savings from processing material through the Waste Minimization Facility
- Financially close-out physically completed capital projects within 120 days
- Commence the Environmental Impact Study for each of the Tritium production mission alternatives
- Aggressively eliminate unnecessary, slow-moving or inactive inventories
- Fully support the CFO Business Management Process (BMP) providing SR with monthly performance graphs and reports by the 10th workday of each month
- Pour a minimum of 150 canisters of vitrified glass at the Defense Waste Processing Facility

Copies of the complete AOP are available by contacting the SR Budget Office at (803) 725-5559.

All of the following Operational Awareness Activities flow from, and support the accomplishment of, the detailed provisions of the AOP.

## **B. SR'S OPERATIONAL AWARENESS ACTIVITIES**

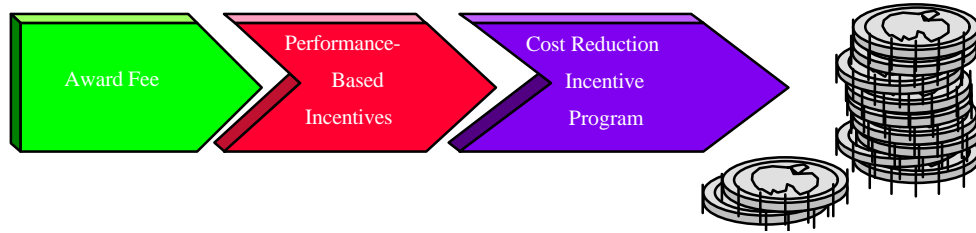
The following analyses, processes and activities comprise SR's Business Management Process for assuring effective financial stewardship consistent with the program goals outlined in the AOP.

### **Contractor Incentive Programs**

Once the operating plan is completed and the program goals, work scope, and funding levels are determined, performance standards and contractor incentives can be established. These standards and incentives can be established as an award fee program, performance based incentives (PBI's) incorporated into contracts, or as part of a cost reduction incentive program (CRIP). In the case of an award fee program and PBI's, the contractor is monetarily rewarded for meeting or exceeding a mutually agreed upon performance measure, milestone, or overall appraisal of operations. In the case of a CRIP, the contractor is compensated for innovative processes that result in definable cost savings to the Department and are outside the scope of their ordinary expected duties. In either case the contractor is only rewarded when warranted by outstanding performance.



SR uses contractor incentive programs to reward efficiencies and cost-cutting measures.



### Business Management Process (BMP) Targets

Currently, the Department is increasing the transition into performance based management. One of the key related processes recently implemented is the BMP. This process requires partnering between the contractor and DOE to develop meaningful performance objectives and measures that represent the most critical aspects of the respective functions. Once these performance measures and outcome expectations are established, the contractor is required to perform an annual self-assessment that focuses on their performance in relation to the expected targets. These self-assessments are then validated by DOE during an annual review.



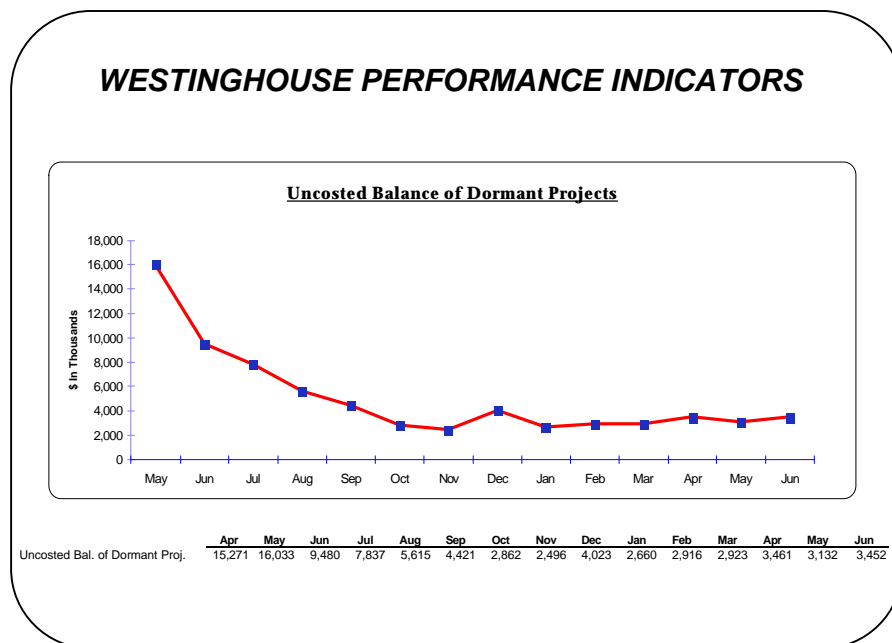
SR currently tracks 18 mutually agreed upon BMP targets.

## Performance Measures

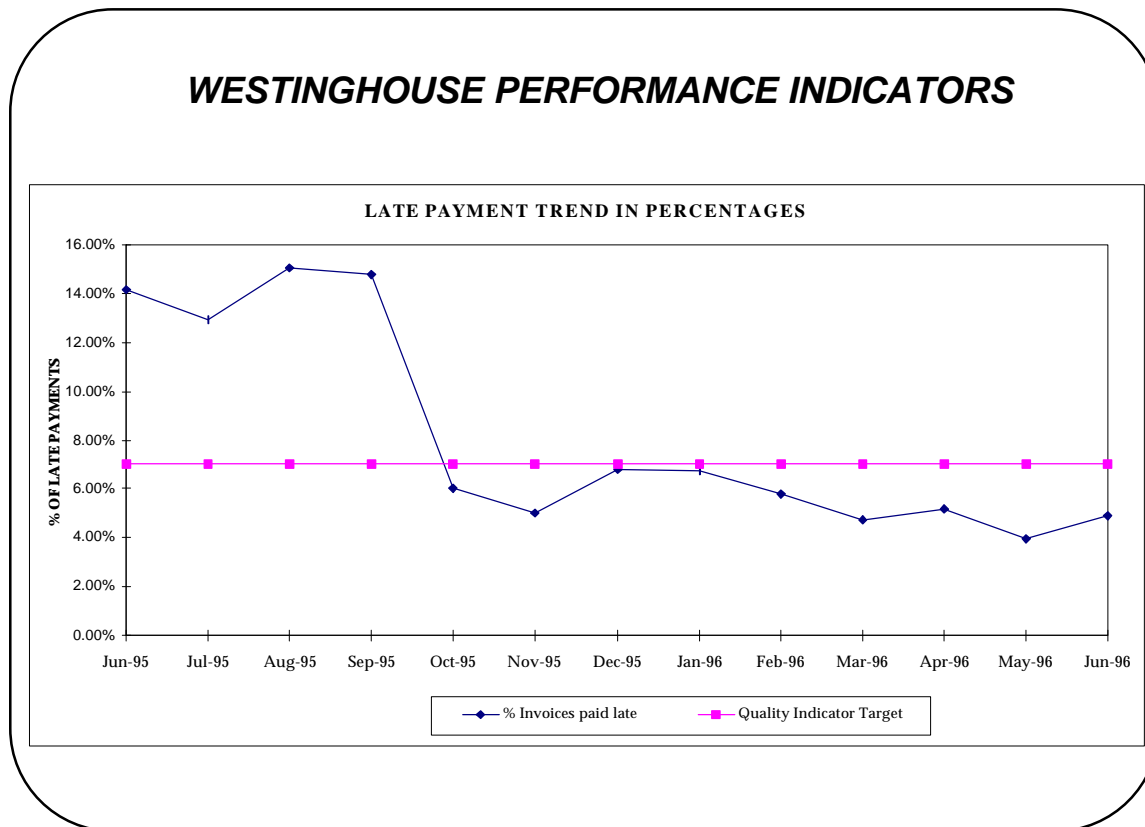
Performance measures should be developed for items of interest that can reasonably be quantified and tracked on a routine basis. The monthly or quarterly tracking of cost or usage data can provide detail insight into specific operations and can alert management to trends that signal potential adverse consequences. These trending warnings should initiate efforts to investigate the rationale for the trends and to develop corrective actions if necessary. Early detection of potential problems and developing solutions is one of the many benefits of using performance measures to track and monitor contractor performance. Examples of financial information that can be monitored through the use of performance measures include:

- Uncosted balances
- Unobligated balances
- Late payment trends
- Travel voucher processing and expenditures
- Accounts receivable trending
- Overtime, annual leave, and sick leave usage
- Indirect costs

## DOE-SR and M&O Contractors develop, track, and analyze Performance Measures - Sample 1



## Performance Measure Graph - Sample 2



SR currently develops, analyzes and tracks 43 performance measures.

### Monthly Program Executive Reports

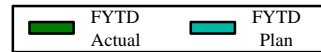
The Finance Division at each site should meet with each Assistant Manager to determine the financial information necessary for optimum program/project management in each functional area. Individual reports should be tailored to meet the requirements requested by each functional area. A routine schedule for preparation of the executive reports should be developed that ensures that the information included and disseminated to the functional areas is current and useful. The accuracy and timeliness of this information is critical for effective and efficient monitoring of operations. Examples of types of information included in these executive reports are:

- Summaries of high visibility items of interest
- Current staffing level vs FY planned staffing levels
- Actual monthly cost vs planned costs
- Actual year to date cost vs planned costs.
- Analyses of variances for operating, capital, and line item/GPP funded expenditures.

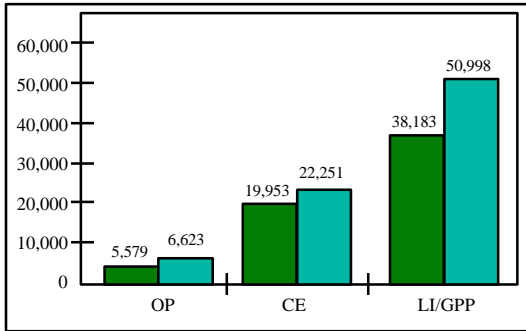
# Monthly Executive Report - Sample 1

## Actual vs. Planned Costs Through June 1996

(\$000's)



### 01.10 Site Infrastructure

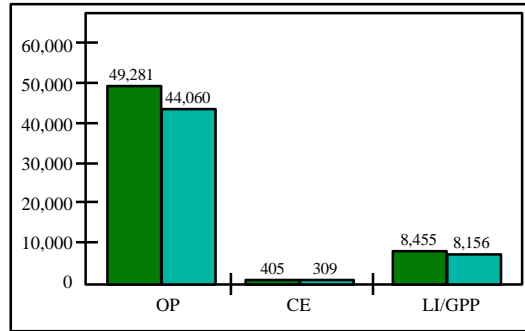


**Operating** - Variance is within threshold.

**Capital Equipment** - The CE underrun variance of \$2.3M is attributable to the SRTC Analytical Labs projects. The underrun is due to manpower shortages, higher priority activities, and delays in authorization of new project starts and receipt of construction materials.

**Line Item/GPP** - Plantwide Fire Protection is underrunning by \$6.2M due to significantly less than anticipated subcontract awards, implementation of commercial practices, and scope optimization. The HP Calibration Facility Project underrun of \$1.5M is due to inclement weather and work scope changes. The GPP underrun is attributable to delays in conceptual design activity, procurement changes, and material delays.

### 01.11 Solid Waste Management



**Operating** - The change control to implement the funding made available from reprogramming was allocated to the last three months of the year. Therefore, the overrun will reverse itself by year end.

**Capital Equipment** - The variance is within threshold.

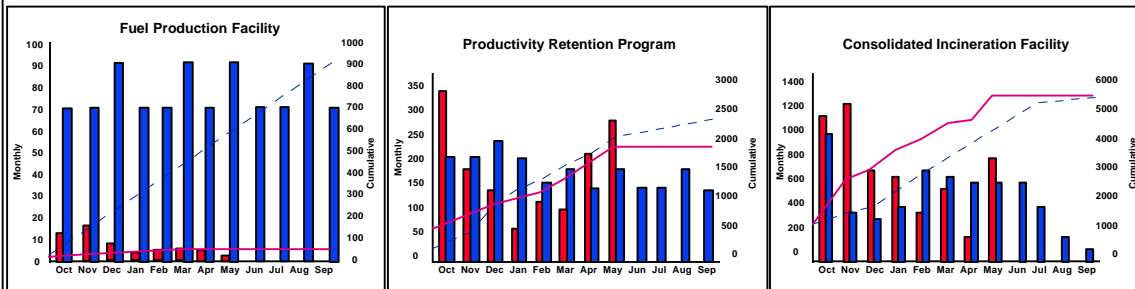
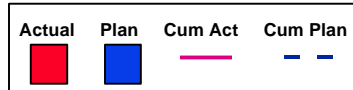
**Line Item/GPP** - The variance is within threshold.

# Monthly Executive Report - Sample 2

## High Visibility Projects

### Actual vs. FY96 Plan

(\$000's)

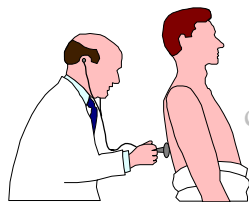


These monthly Executive Financial Reports are usually 10-20 pages, in length, provide timely variance analysis, and are available to management by the 6th workday following each month.

### Management by Walking Around

Sincere face-to-face interaction between DOE and its contractors is the most effective means of communication available. This personal interaction should occur as frequently as needed and should foster an open and trusting relationship between DOE and its contractors. This interaction will prevent DOE from being “cut off” from its contractors and colleagues and will provide a more current insight into major trends and issues affecting the contractor.

## SR Practices “Management-by-Walking-Around”.



We listen to the “pulse” of the contractor organization to identify major trends and issues.

We hold “face-to-face” meetings as often as possible to avoid “memo blizzards”.



### Quarterly Budget/Spending Status Meetings

It is important to perform quarterly analyses of the contractor’s program execution and to analyze spending trends to provide an “early warning” system for cost overruns or indications of potential funding problems. These quarterly analyses enable the CFO to assess the “big picture” of the sites financial condition. This will help identify any areas needing more frequent tracking and development of corrective actions when necessary.

## Quarterly Budget Spending Status Meeting Document - Sample 1

FY 1996 OPERATING COST ESTIMATE ANALYSIS AS OF SECOND QUARTER										
WBS SUMMARY										
ELEMENT OF EXPENSE SUMMARY BY QUARTER										
(Dollars in Millions)										
* WBS: 1.05 - HIGH LEVEL WASTE										
	1st QTR ACTUAL		2nd QTR ACTUAL		3rd QTR ESTIMATED		4th QTR ESTIMATED		FY96	
COST ELEMENT:	ENCUM	COST	ENCUM	COST	ENCUM	COST	ENCUM	COST	ENCUM	EAC
<b>LEAD DIVISION:</b>										
LABOR & OVERHEAD	30,057	30,057	26,834	26,834	26,563	26,563	26,220	26,220	109,674	109,674
POWER & OTHER	0	0	0	0	0	0	0	0	0	0
MATLS & SUBCONTRACTS	646	3,272	296	7,160	1,779	4,542	483	6,986	3,204	21,960
SUBTOTAL	30,703	33,329	27,130	33,994	28,342	31,104	26,703	33,206	112,878	131,634
<b>SUPPORT DIVISIONS:</b>										
NMSP/DP	0	59	0	45	0	60	0	82	0	247
E&CSD	561	10,891	693	10,232	317	10,675	243	11,055	1,815	42,853
SRTC	6	6,714	73	6,230	22	7,511	0	7,346	101	27,801
A&ID	0	4,187	0	4,382	0	4,097	0	4,063	0	16,729
ESH&QA	0	5,693	0	6,062	0	5,944	0	5,806	0	23,505
SS&ES	0	903	0	1,048	0	689	0	677	0	3,317
OTHER	0	36	0	44	0	149	0	594	0	824
SUBTOTAL	567	28,484	766	28,042	339	29,125	243	29,623	1,916	115,275
LEVEL 2 WBS TOTAL	31,270	61,814	27,896	62,036	28,681	60,229	26,947	62,829	114,794	246,909

**NOTES:**

- 2nd Qtr Mat'ls/Subcontracts reflects ITP STPB Lawsuit accrual.
- 4th Qtr Mat'ls/Subcontracts reflects ITP STPB chemical procurement.
- 4th Qtr E & CSD Increase reflects ITP Nitrogen Inerting System Activity.
- 3rd / 4th Qtrs SRTC increase reflects WM Technology Development and ITP Benzene resolution.
- 3rd / 4th Qtrs "OTHER" increase reflects SWER Waste Chargeback.
- Matls & Subcontracts encumbrance includes new P.O.'s & PRCN's. Does not include stores orders and essential chemical withdrawals.

## Quarterly Budget Spending Status Meeting Document - Sample 2

STATUS OF FUNDS FY96							
DEFENSE PROGRAMS							
(in Millions)							
PROGRAM	BEGIN UNCOSTED	NEW BA	TOTAL AVAILABLE	EAC	ENCUMB.	PROJ. UNCOSTED	
CORE STOCKPILE MGMT. (DP0401)							
OPERATIONS	6.10	88.44	94.50	88.20	3.30	3.00	
DOE OTHER (WSI, SREL, FED SUPP.)	1.90	5.96	7.90	5.30	0.00	2.60	
SUBTOTAL	8.00	94.40	102.40	93.50	3.30	5.60	
PIT WORK	0.00	0.25	0.30	1.00	0.00	-0.80	
MATERIALS SURVEILLANCE (DP0405)	0.00	4.00	4.00	4.00	0.00	0.00	
RAP (DP0402)	0.20	0.19	0.40	0.30	0.00	0.10	
NNR (DP0403)	2.10	5.76	7.90	5.60	0.00	2.30	
MINOR PROGRAMS	0.10	0.00	0.10	0.00	0.00	0.10	
APT (DP0404)	0.00	17.00	17.00	11.50	5.50	0.00	
CLWR (DP0404)	0.50	3.10	3.60	1.10	2.50	0.00	
PROGRAM SUPPORT (DP040406)	0.00	0.15	0.15	0.15	0.00	0.00	
ES&H SUPPORT FOR HQ (DP0405)	0.96	0.41	1.37	0.97	0.00	0.40	
<b>TOTAL</b>	<b>11.90</b>	<b>125.30</b>	<b>137.10</b>	<b>118.20</b>	<b>11.30</b>	<b>7.70</b>	

These meetings usually last one full day, include both programs and financial staff, and delve into whatever depth is needed to satisfy Operations office staff that programs are being carried out efficiently and effectively.

### Monthly Financial Statements Analysis Meetings

The SR Finance Director and contractor counterpart should participate in monthly performance results meetings to review and analyze balance sheet and income statement trends. During these meetings, changes in balance sheet items such as accounts receivable, inventories, capital equipment and other assets are discussed. This interaction helps keep DOE informed of significant changes occurring throughout the site.

## Financial Results Details - Sample 1

WESTINGHOUSE SAVANNAH RIVER COMPANY				
BALANCE SHEET				
MAY 1996				
DESCRIPTION	APRIL 1996	MAY 1996	PRIOR MONTH	CHANGE FROM
ASSETS (continued)	BALANCE	BALANCE	NET CHANGE	PRIOR YEAR END
<b>ACCOUNTS RECEIVABLE</b>				
INTER-DOE FIELD OFFICES	733,029	720,857	(12,172)	(283,511)
ACCOUNTS RECEIVABLE FROM OFA	397,162	328,538	(68,624)	(174,871)
OTHER ACCOUNTS RECEIVABLE AND INTEREST	1,992,232	1,828,889	(163,343)	(515,822)
ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS RECEIV.	(16,369)	(16,369)	0	41,068
TOTAL ACCOUNTS RECEIVABLE	3,106,052	2,861,913	(244,139)	(933,136)
<b>INVENTORIES</b>				
STOCKPILE, PRODUCTION AND SS MATERIAL INVEN.	2,468,022,982	2,474,972,259	6,949,277	83,519,999
STORES	106,163,520	111,425,283	5,261,764	(8,887,788)
ALLOWANCE FOR LOSS ON STORES	(21,057,595)	(25,878,623)	(4,821,028)	9,471,995
OTHER SPECIAL MATERIALS	2,381,243	2,365,468	(15,775)	68,076
FUEL FABRICATION COSTS INVENTORY	0	0	0	0
ISOTOPIES	0	0	0	0
TOTAL INVENTORIES	2,555,510,151	2,562,884,388	7,374,237	84,172,282
<b>PLANT AND EQUIPMENT</b>				
COMPLETED PLANT AND EQUIPMENT	4,375,337,612	4,378,024,323	2,686,711	96,400,863
ACCUMULATED DEPRECIATION	(2,187,623,431)	(2,439,273,065)	(251,649,634)	(363,182,063)
NET COMPLETED PLANT	2,187,714,181	1,938,751,258	(248,962,923)	(266,781,200)
CONSTRUCTION WORK IN PROGRESS	2,016,430,875	502,677,530	(1,513,753,345)	(1,522,914,427)
TOTAL PLANT AND EQUIPMENT	4,204,145,055	2,441,428,788	(1,762,716,268)	(1,789,695,628)
<b>OTHER ASSETS</b>				
LOANS AND LONG TERM RECEIVABLES	0	0	0	0
INVESTMENT IN U.S. GOVERNMENT SECURITIES	0	0	0	0
PREPAYMENTS AND OTHER ASSETS	2,134,935	2,208,371	73,436	1,948,923
TOTAL OTHER ASSETS	2,134,935	2,208,371	73,436	1,948,923
<b>TOTAL ASSETS</b>	<b>6,764,931,008</b>	<b>5,009,417,317</b>	<b>(1,755,513,691)</b>	<b>(1,704,650,781)</b>

# Financial Results Detail - Sample 2

INVENTORY SUMMARY					
TITLE	BEGINNING INVENTORY 10/01/95	PREV. MONTH INVENTORY 05/31/96	CURRENT INVENTORY 06/30/96	CURRENT MONTH CHANGE	FYTD CHANGE
Stores - Process Spares	60,397,274	60,559,396	60,947,211	387,815	549,937
Stores - Common Use	10,168,198	9,985,867	10,197,001	211,134	28,803
Reserve for Write Offs	(5,168,187)	(1,106,446)	(1,045,151)	61,295	4,123,036
Total Stores	65,397,285	69,438,817	70,099,061	660,244	4,701,776
Essential Materials	16,598,153	17,597,725	16,174,230	(1,423,494)	(423,923)
Coal	4,597,452	307,913	312,185	4,272	(4,285,268)
Reserve for Write Offs	(2,483,544)	(2,483,544)	(1,617,946)	865,598	865,598
Total Essential Materials	18,712,061	15,422,093	14,868,469	(533,624)	(3,843,592)
Excess Material	28,551,994	22,974,383	24,871,870	1,897,487	(3,680,124)
Reserve for Write Offs	(27,698,886)	(22,288,632)	(24,129,194)	(1,840,562)	359,692
Total Excess Material	853,108	685,751	742,676	56,925	(110,432)
Precious Metals	2,288,371	2,357,632	2,350,737	(6,895)	62,366
Total Inventory	\$ 87,250,825	\$ 87,904,292	\$ 88,060,943	\$ 156,650	\$ 810,118

**INVENTORY TREND**

Period	Value (\$ Millions)
09/30/90	86.3
09/30/91	103.7
09/30/92	110.2
09/30/93	110.0
09/30/94	97.5
09/30/95	87.3
FYTD96	88.1

## On-going Financial Analysis

SR consistently performs analyses of key components of contractor financial data such as inventory turnover, growth management, overhead pools, etc. This analysis is a fundamental responsibility of financial management and is necessary to keep DOE better informed of overall contractor operations and performance. The frequency of these analyses will depend upon each sites unique circumstances.

## Weekly Financial Strategy Meetings Between SR CFO and M&I CFO (and key staff)

The CFO's and other key personnel from SR and the contractor hold weekly meetings to evaluate emerging trends and developments affecting the site. These meetings will focus on current significant issues and provide the opportunity for free exchange of ideas, concerns, and team approaches to prudent decision making.

## "For Cause Reviews"

"For cause" reviews are performed as a result of the identification of significant problems or trends through day to day operational awareness and analysis of contractor self-assessments. These reviews will vary in scope from brief fact-finding assessments to extensive detailed reviews, dependent upon the circumstances. These reviews may be performed on a priority basis at any time throughout the year.



## Audit and Review Findings

The CFO is responsible for coordinating and ensuring that contractors respond to audit and review findings. These audit and review findings can be generated internally by “for cause” reviews, or contractor internal audit efforts as well as external audit sources such as the Office of Inspector General (OIG), General Accounting Office (GAO), or the Defense Contract Audit Agency (DCAA). The CFO ensures that all valid recommendations are implemented completely and in a timely manner.

## **III. ALBUQUERQUE’S FINANCIAL STEWARDSHIP PROGRAM**

### **A. Purpose**

This document describes the Financial Stewardship Program utilized by the Albuquerque Operations Office in evaluating the performance of contractor and AL financial management systems.

### **B. Introduction**

In Fiscal Year 1995, the Department of Energy piloted a new method for conducting oversight of the Management & Operating Contractors, performance-based management. This process relies on clear performance expectations from DOE, contractor self-assessment, and integrated reviews by DOE functional areas. The enactment of the Government Performance and Results Act and the Chief Financial Officers Act have placed additional importance on the need to improve and report on Government financial systems. The Albuquerque Operations Office’s Field Chief Financial Officer has instituted a financial stewardship program (FSP) in response to these new requirements. This program allows AL to effectively manage its financial processes and obtain insight into the contractor financial management systems.

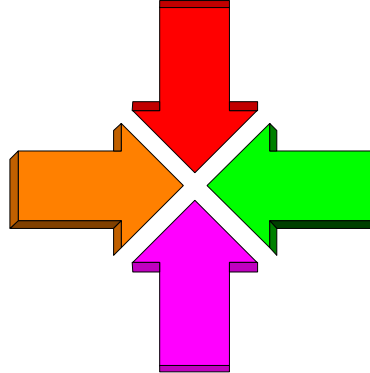
Financial Stewardship is the name we have coined to describe the totality of the efforts by both the Albuquerque CFO and its contractors to provide for the effective and efficient execution of their financial responsibilities to help ensure the optimum use of taxpayers’ dollars and the protection of the Department’s assets against fraud, waste, abuse, and mismanagement.

Our financial stewardship program is operational, effective, and integrated using the guiding principles of performance-based management, to determine whether the contractor’s and DOE’s financial systems are efficient and have adequate internal controls to ensure that management objectives are accomplished.

The FSP provides the basis from which the Field Chief Financial Officer can reasonably assure that financial management systems have adequate controls as required by the annual Management Representation Letter. Presented below are the key elements of the FSP.

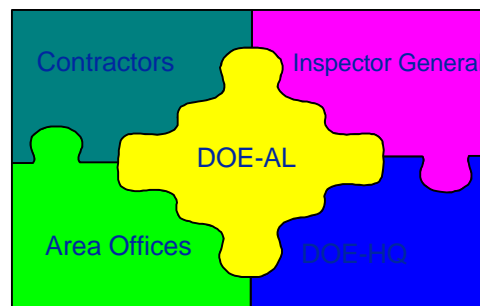
# Key Elements of Program

- Risk Based Approach
- Focused on Internal Controls
- Partnering
- Continuous Process and Performance Improvement
- Integrated Oversight
- Comprehensive Approach



## C. Program Participants

Several organizations participate directly in the AL Financial Stewardship Program. They include: the AL CFO divisions, Financial Management and Internal Audit Organizations at five geographically dispersed management and operating contractor sites, cognizant area office sites, Headquarters Office of Audit Liaison and Compliance, and DOE Office of Inspector General.



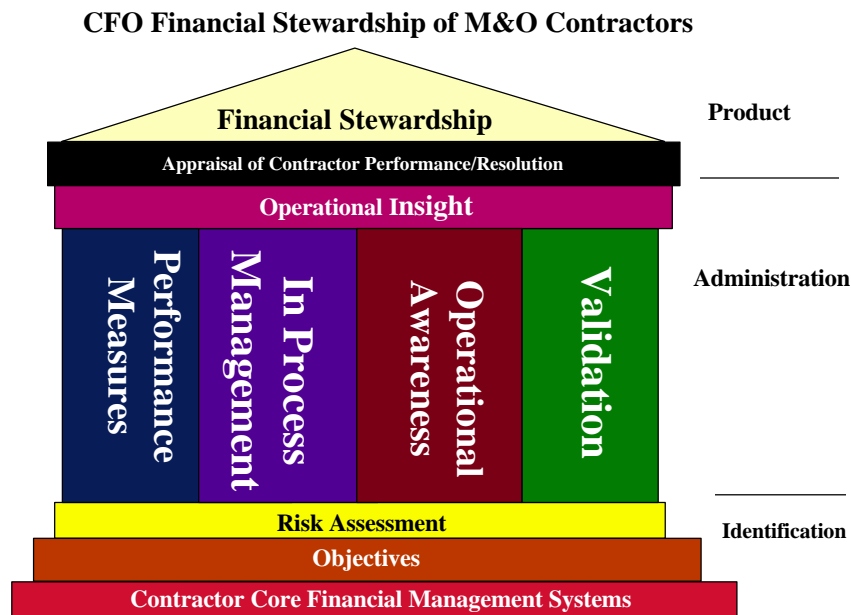
## D. Program Structure

In addition to using the premise of performance-based management, the FSP was developed using the approach recommended by the COSO Framework for evaluating internal controls. The COSO stands for the Committee of Sponsoring Organizations of the Treadway Commission, which was comprised of representatives from the American Institute of Certified Public Accountants, the American Accounting Association, the Institute of Internal Auditors, the Institute for Management Accountants, and the Financial Executives Institutes. That committee established the standard definition for internal control and promulgated guidance for the evaluation of the effectiveness of internal controls. The COSO model is based on focusing effort and attention on those areas which are the highest risk to the entity. The model defines internal

control as the process designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

The FSP can best be described using the imagery of a house.



As the image indicates, the FSP can be divided into three phases: identification, administration, and products. The identification phase separates, defines, and ranks based on risk the processes involved in financial management. The administration phase monitors, reports, evaluates, and verifies the performance of the financial systems. The product phase provides opinions on the effectiveness and efficiency of the financial management systems.

Each phase is described in greater detail in the next section.

### **E. Identification Phase**

The identification phase is the foundation of the FSP. In this phase the fundamental questions of “what”, “why” and “so what” are answered. The “what” refers to what activities comprise financial management. The “why” refers to what management expects the activities to accomplish. The “so what” refers to the critical activities which are most important to management.

## Contractor Core Financial Management Systems

For the purposes of evaluation, the financial management function has been broken down into ten financial management processes. These processes establish the basis on which to evaluate financial management

## Identification



### ■ Identify Financial Systems

- Used previously defined financial systems as a base along with industry standards & IG manual
- 10 financial systems

### ■ Describe Control Systems

- Contractor describes key control systems
- DOE analyzes to obtain general understanding of control effectiveness.

## Objectives

This step describes the “why” of the financial management processes. Specifically, the objectives for each financial management process establish the management goals for the process. The internal control systems, in turn, ensure that these objectives are accomplished. Establishing objectives is the pre-cursor to assessing the risk associated with each process. Each objective is also broken down into sub-objectives in order to perform an assessment of risk, which is described in the next segment. From the ten objectives, fifty-nine sub-objectives were identified and used in the risk assessment process.

## Risk Assessment

The outcome of this process provides a listing of the 59 sub-objectives ranked in priority according to risk posed to the entire financial organization. The listing provides a corporate statement on responsibility and risk, drives the measurement process, and establishes priority for evaluation of financial management control systems. The goal of the ranking process is to focus contractor efforts on the vital few financial systems and to determine the effectiveness of the control systems required for each one of them. The AL/CFO risk assessment process is a corporate initiative which includes representatives from the Area Office, Contractor Financial Management, AL/CFO organizations, and Contractor Internal Audit.

We incorporated five comprehensive high level risks to governmental financial operations into our ranking criteria:

1. Risk of Augmentation
2. Risk of Anti-deficiency

3. Risk of Other Violations of Appropriation Law
4. Risk of Loss of Government Funds/Assets, and
5. Risk of Cost of Inefficient Operations

In addition to the five comprehensive risks, several other factors are considered in the risk assessment: Visibility, Scope of Impact, Volume, Feasibility, and Historical Information. Together, the factors evaluate the potential exposure (internal and external to the process) and the potential impact to the DOE community while considering the cost to implement controls and the relative confidence level of the control system. The overall listing of sub-objectives ranked by risk is used to focus effort on the areas which pose the most risk to the DOE community.

Presented below is an example of the results of our risk ranking evaluation.

Process	Sub-objective	Ranking
Budget Execution	Proper, timely & accurate recording of obligations	1
Budget Execution	Completeness of information	2
Cost Accounting	Adequate classification of costs	3
Cost Accounting	Distribution of costs in compliance with CAS	4
Accounts Payable	Completeness of information	5

A comprehensive guidance document for performing a risk assessment on financial processes is available from the Management Review Division, AL.

## **F. Administration Phase**

The administration phase is where information is gathered, reported, and evaluated. Four mechanisms are available to use to collect the information: performance measures, in-process measures, operational awareness, and validation. The mechanism to use will depend on the availability of information, the cost to collect information, and whether the information can be measured. A combination of mechanisms can also be used to obtain a complete understanding of how well the process is working. A description of each mechanism follows this segment.

The fundamental question to answer is “What behavior is desired for this process?” If the desired behavior is improvement and the process can be measured (a graphic or metric can be used), then the best method is a performance measure. If the desired behavior is to maintain a level of performance and the process can be measured, then the best method is an in-process measure. If the desired behavior is compliance or the process cannot be measured, then the best methods may be operational awareness or validation.

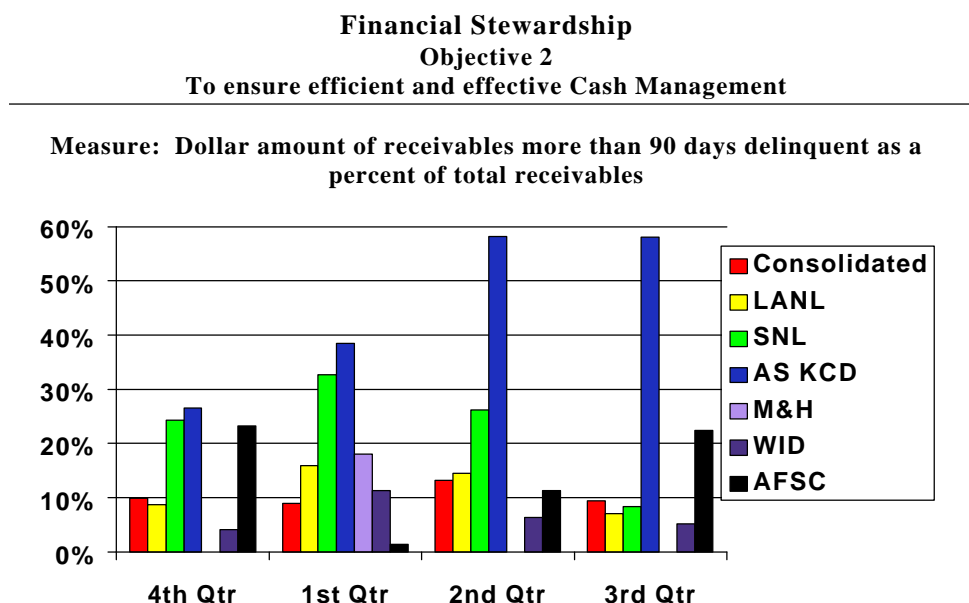
### **Operational Awareness**

Operational awareness refers to the comprehensive understanding that the AL/CFO and the area offices possess based on the operational interaction they have with the contractors. Operational awareness is a crucial element of the Financial Stewardship Program. It is at this stage where the understanding from the different AL financial functional components become integrated to form

the overall knowledge of the performance of each contractor's financial processes and the foundation for the annual assessment of performance.

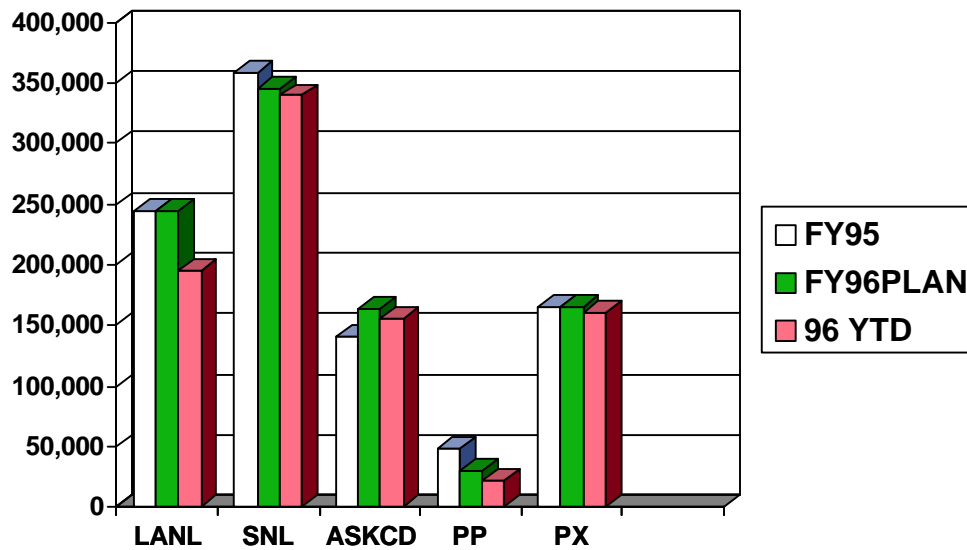
Some operational awareness activities may be conducted at a corporate level within the CFO organization, while other operational awareness activities are independently conducted by each Division. Some examples of corporate operational awareness activities are the annual risk assessment, development and negotiation of contractor performance objectives and measures, and the annual review of each contractor's financial management performance.

Some types of operational awareness activities vary by site and by each Division within the AL CFO. The Albuquerque Financial Service Center uses operational awareness activities to maintain insight and/or oversight of the management and operating contractors financial management function. These activities include day-to-day liaison communications, quarterly status briefings by the contractors, liaison visits, interpreting DOE financial policy, providing policy guidance to the contractors, analyzing results of financial performance, and resolving contractors' financial management issues. An illustration of financial analysis is presented below:



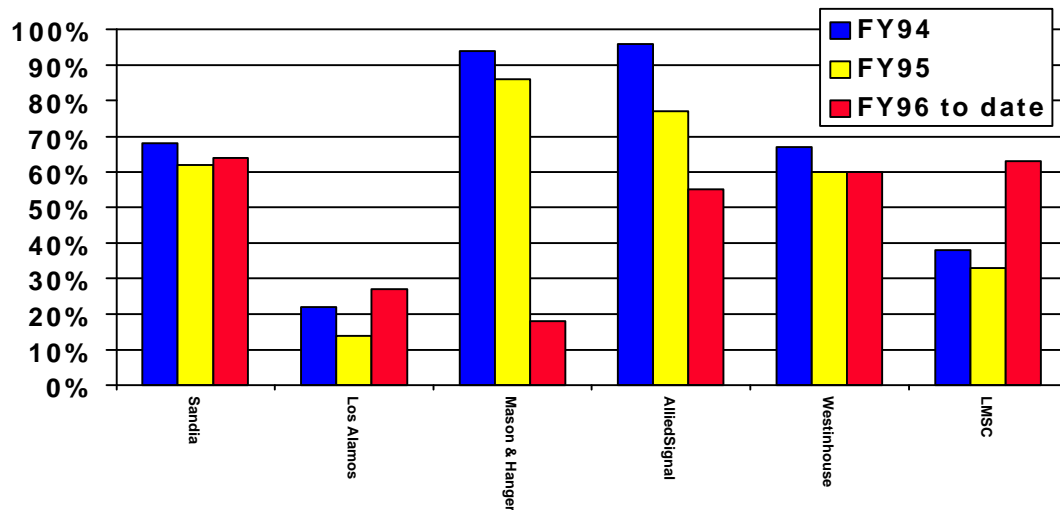
The Budget and Resources Management Division determines the status of contractor budget and resource management related to each of AL's programmatic missions as well as site landlord requirements. Operational awareness activities include providing formal programmatic budget guidance and priorities to the Nuclear Weapons Complex contractors for Defense Programs and the Environmental Management Program, analyzing contractor obligation and cost data, site liaison visits to discuss and resolve programmatic mission issues and observe contractor performance in accomplishing expected results, and conducting formal on-site budget reviews designed to ensure accomplishment of programmatic goals, objectives, and priorities. Presented below is an example of a budget analysis tool:

### FY 1996 Allocable Costs



The Management Review Division conducts its operational awareness activities to provide a sound and reasonable basis that AL and the management and operating contractors financial management systems operate effectively, efficiently, and comply with applicable requirements. These activities include evaluating all aspects of financial management processes within AL and the contractors, drafting Departmental positions regarding accounting and auditing issues and determining appropriate corrective actions, interfacing with contractor internal audit offices, and analyzing reports generated by the contractors audit departments, Office of Inspector General, and the General Accounting Office. An example of an internal audit function analysis is presented below:

## Percentage of Audit Plans Accomplished by Internal Audit Functions (10/28/96)



### Performance Measures

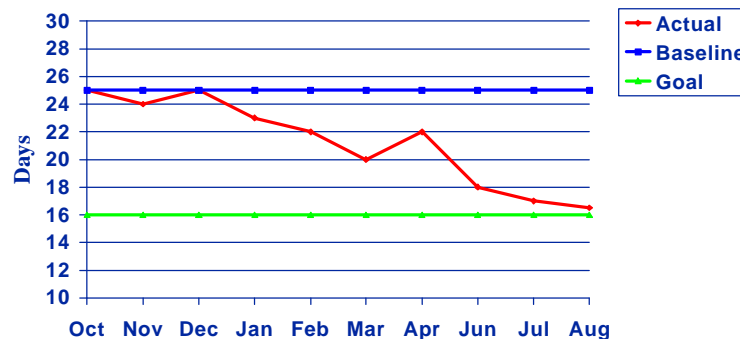
Performance Measures provide information on how a process has improved. The improvements are tracked using graphs or metrics because the focus of performance measures is on results. Those results can be expressed in either an improvement in efficiency, such as a reduction in cycle time or cycle steps, or as improvement in effectiveness, such as a decrease in process costs while maintaining process results.

The following steps should be used to utilize performance measures:

- Identify what activities should be improved
- Determine current performance levels (baseline) and establish goals or targets
- Monitor performance through measurements



## Example of Collection Cycle Time Performance Measure (Improvement)



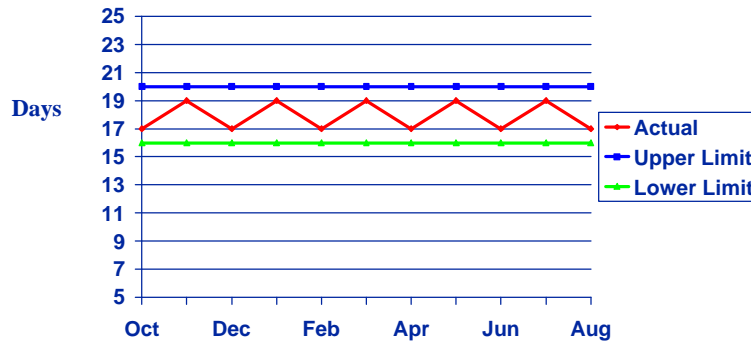
### In-process Management

In-process management provides information on how a process has performed. The emphasis is to maintain performance within certain parameters, not to drive improvement. In-process management measures how well a process maintains a mandated or established cycle time or specified process results. These measures help identify whether control systems are working effectively to accomplish management objectives. In-process measures do have some limitations. They are only applicable to processes/sub-objectives in which a measure/graph/metric would be useful. They cannot verify that all control systems are effective as control systems are difficult to metric. They can, however, be useful tools in the overall evaluation of control systems when combined effectively with validation and operational awareness activities.

The following steps can be used to utilize in-process management:

- Identify which sub-objectives can be measured and in which performance levels should be maintained.
- Define the expected levels of performance with upper and lower limits. (Upper and lower limits provide a range in which the process can operate. Performance falling outside these limits would indicate that controls systems have failed.)
- Monitor performance using metrics and periodic reporting.

## Example of Collection Cycle Time In Process Measure (Maintain)



### Validation

Validation is where the process' control systems are actually tested. This can be done through a variety of ways:

- Day-to-day observations
- Contractor self-assessments
- DOE annual review
- Internal audits
- External audits (Office of Inspector General/General Accounting Office, etc.)

This mechanism is also critical in that many of the control systems used cannot be measured or evaluated any other way.

### G. Product Phase

The product phase is the fundamental difference between the FSP and previous oversight methods. This phase is where results of all the mechanisms are combined and the overall picture of performance is developed. The products include operational insight, assessment of performance and resolution of issues, and overall financial stewardship is achieved.

### Operational Insight

Operational Insight is the integrated operational understanding of the effectiveness of the financial management processes. The insight occurs at two levels. The first level refers to the individual financial processes and individual financial management systems (contractor and AL). The second level refers to how effective the financial management processes and financial management systems are as a whole, with all contractors and AL combined.

**Assessing Contractor Performance/Resolution**

One overall goal of the FSP is to provide a sound basis for the assessment of contractor performance. The integration observed at the operational insight segment provides this basis and allow for a comprehensive and complete evaluation of contractor performance. This assessment considers the relationship of issues to the whole financial management system, thereby eliminating the tendency to consider issues only in the assessment.

**Financial Stewardship**

The ultimate product is the achievement of financial stewardship, which provides for the effective and efficient execution of financial responsibilities to help ensure optimum use of taxpayers' dollars and protection of the Department's assets against fraud, waste, abuse, and mismanagement.

**IV. CONCLUSION**

Both SR and AL approaches to effective financial management oversight successfully incorporate the concepts of contract reform, streamlining of contractor oversight, elimination of duplicative and unnecessary reviews and adhere to the guiding principles outlined in Chapter 1 of this document.

SR and AL use partnering with the contractor to develop specific performance goals, establish incentives, and perform operational awareness activities, which provides the CFO and DOE management with a comprehensive financial management program. Both financial management programs provide the CFO and DOE management with the information necessary to evaluate planning, manage resources, provide accurate financial reporting, and to ensure effective and efficient use of Government resources on a consistent and routine basis. Although each approach is tailored to fit the operations and unique contractual arrangements of each office, both models satisfy the spirit and intent of the Department's Contractor Performance-based Management Process, and legally mandated responsibilities related to responsive, economical, efficient, and effective financial administration.